

TCL E

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Implications of Forcing a Polish DefaultBackground Summary

I. The 31 December 1981 Treasury paper--which we generally agree with--notes that invocation of the "Exceptional Circumstances Clause" (or "Tank Clause," whereby creditors can suspend, after consultation among themselves, their debt rescheduling agreement if the Soviets intervene directly or if the Polish Government acts to reimpose a repressive regime) would, in Eastern Europe:

- A. Cause economic chaos in Poland,
- B. Force a Romanian rescheduling or default, and
- C. Put financial pressure on East Germany and Yugoslavia, but
- D. Of the other East European countries, only Hungary would be significantly affected, and it could be expected to cope.

Concerning Western financial markets, forcing a default would:

- A. Cost governments \$10 billion and private banks more than \$9 billion, but
- B. National banking systems should be able to survive--with government aid.

The key danger, which both we and Treasury consider unlikely, is a bloc-wide default which would:

- A. Involve the loss of \$50 billion in private bank claims,
- B. Create short-term panic and loss of confidence in the Western banking system,
- C. Dry up trade with the East, and
- D. Possibly induce other Western countries to form a defensive circle to offset or counter US actions.

II. Treasury's conclusion is that invoking the "tank clause" would be unwise because:

- A. There are no assurances that it would bring about the desired effects on Soviet and Eastern Bloc access to

Western financial markets so as to reduce substantially or halt credit sales of grain or other products to the USSR.

B. It could prove extremely costly to the United States and to the West, particularly if it resulted in a bloc-wide default.

C. It would ultimately tear down the institutional mechanisms that we have worked so hard over the postwar years to build and maintain: our monetary system and the free flow of trade, investment, and capital.

Economic Impact on Eastern Europe and the USSR

III. Poland

A. The financial impact on Poland, which is already in de facto default, would be small.

1. Western creditors may seize the small amount of Polish assets in the West and cargoes of titled goods.

2. Polish trade could be further disrupted by litigation.

3. On the other hand, Poland would receive relief on its huge debt burden;

4. And, any credits or humanitarian aid would feed directly into the Polish economy rather than be diverted for debt service.

IV. Eastern Europe

A. Western banks would be even less willing than now to extend new loans, particularly to hard-pressed Romania and Yugoslavia.

B. The East Europeans would probably adjust by reducing imports from the West from already modest levels and by pressing Moscow for additional economic assistance.

C. Much depends on how our European allies react. West Germany, in particular, is likely to continue its preferential treatment of East Germany.

V. USSR

A. There is no automatic and direct link between a Polish default and Soviet access to credits.

B. Bankers would hold Moscow at least partially responsible for Poland's default.

C. Bankers would still consider the USSR as a reasonably good risk.

D. Whether bankers in Western Europe would cut back on credit to the USSR would depend on their respective governments' policies on guaranteed credit lines.

E. Bankers would probably not want to participate in general-purpose loans to the USSR.

Political Implications for Eastern Europe & the USSR

A. Any US action precipitating a domino effect on the economies of the East European states would hit most severely those states that have attempted most to pursue foreign and domestic policies independent to the USSR--Yugoslavia, Romania, and to some extent Hungary. Such action could accordingly be misinterpreted as a US repudiation of such policies and those East European leaders that pursued them.

1. To the extent that economic dislocations increased popular deprivation, increased incidents of unrest might occur and would have the effect of increasing Soviet pressure on these regimes to accept Soviet guidance and to clamp down on their own publics.

2. In Yugoslavia, where Soviet leverage is comparatively small, economic distress would have the effect of undermining the regime's strategy of buttressing the unity of its ethnically diverse state by having the richer republics help economically develop the poorer. Major incidents of unrest have already occurred in the post-Tito period--among the Albanians of the Kosovo region--and might well spread.

B. Most East European leaders would probably attempt to improve their relations with the USSR by retreating from their independent policies, both to reduce their vulnerability to Soviet pressures and, in the hope of gaining Soviet assistance, to work their way through their country's additional economic problems.

C. Hard-liners in the regimes of Eastern Europe would be strengthened in their relative power positions, which would add to the likelihood that these states would conform more to Soviet dictate and pursue more repressive policies domestically.

D. Some East European leaders--especially Romania's Ceausescu, but perhaps also Hungary's Kadar--might not

survive the failure of their strategies; any successor leaders would most likely be more willing to accept guidance from Moscow.

II. US measures would, of course, also complicate the economic problems of the USSR's most loyal allies--the GDR, Czechoslovakia, and Bulgaria.

A. All three would be reinforced in their congenital hesitations about intercourse with the West and strengthen repressive domestic policies to preclude any increase in domestic unrest.

B. The GDR would expect West Germany, with which it has a special economic relationship, to assist it with additional aid and credits. The East Germans have traditionally refused to offer political concessions in return, unless so ordered by Moscow in pursuit of broader Soviet upposes. The GDR will probably argue, indeed, that increased West German assistance is required even to preserve existing inter-German humanitarian arrangements.

III. Likely general popular reactions in Eastern Europe are harder to gauge, but a sense of hopelessness about improving their economic or domestic political lot might well develop.

A. This might present their regimes with new problems in the area of worker productivity and the growth of second economies outside regime control.

B. The development of a sense of hopelessness, on the other hand, might also encourage these publics to reconcile themselves to their regimes' domination and to conform to what their regimes demand of them.

IV. The USSR could be counted on to exploit the US action for its own political advantage.

A. It would parlay increased East European economic dependence into firmer Soviet political control.

B. It would use worsened strains in the NATO Alliance to advance Soviet interests in Western Europe.

C. Soviet behavior in the Third World is more uncertain.

1. Moscow could step up support for radical regimes and insurgent movements to demonstrate its resolve.

2. But, economic fallout from US measures might lessen Moscow's readiness to take on costly adventures in the Third World.

Implications for the Alliance

I. Basic Attitudes Toward Sanctions

A. West European reaction to unilateral US invocation of the "tank clause" would be almost universally negative even though most governments recognize that "exceptional circumstances" do indeed exist. Part of this reaction would be due to West Europeans' traditional desire to avoid or delay hard decisions:

1. Western Europe's economic stake in the East, in terms of imports, exports, and debts, is far greater than the US stake.
2. Most West European governments are coalitions and/or are faced with strong opposition parties and labor/business groups that would make life miserable for acquiescing governments.

At the same time, there are some fundamental (and sincere) differences of perception that impede Allied cooperation:

1. Most West European governments do not believe that economic measures are an appropriate or effective response to political or military events (an argument used previously with both Iran and Afghanistan).
2. Many Allies see the timing as bad: order appears to be returning, Jaruzelski's ultimate intentions remain unclear, and Poland has just announced that it can cover the \$350 million in interest payments now due. Further action now is seen as destroying any prospects for Solidarity and the Polish liberalization movement as potentially imposing additional hardship on the Polish people, and as eliminating the chance of getting Western creditors their money back.
3. Although admitting some Soviet complicity in martial law, most West Europeans see Warsaw's actions primarily as a last-ditch attempt to forestall direct Soviet intervention; many, particularly in West Germany, also feel that Solidarity was going too far and that the deteriorating economic situation made a crackdown inevitable.
4. Many Allies also would see further sanctions at

this time as simply punitive measures--against both the USSR (and Poland) and against the West Europeans for their weak response and, incidentally, as a means of halting the gas pipeline.

II. Financial Concerns

A. Unless circumstances change, the West European Allies are unlikely to cooperate with the US default action. Indeed, given their greater financial stake, they might attempt to offset invocation of the "tank clause" by declaring a temporary postponement of Polish payments due them, and possibly by organizing new credit lines. Given the complexities involved--cross-default--clauses and the international syndicate nature of most of the Polish debt, and the probability of major legal hassles--it would be difficult, but not impossible, for the West Europeans to isolate their credits. Cross-default clauses would not necessarily have to be triggered--they generally were not in the Iranian case--and, if both the West European banks and Warsaw cooperate, which appears likely, they could pull it off.

B. Although the West Europeans traditionally have experienced difficulty in cooperating to reach important decisions, the incentives in this case would be great:

1. The financial incentives are obvious--saving government budgets and private banks billions of dollars in debts that, at least temporarily, would not have to be written off and on which some interest may yet be recovered.

2. Trade, although severely disrupted, could continue, and the chances of a bloc-wide default would be reduced considerably.

III. Political Rections

A. Public and media opinion, which has pushed most West European governments to denounce martial law and warn against Soviet intervention, would probably turn against the US action; at the same time, bankers and businessmen naturally would welcome their governments' efforts to forestall Polish default.

B. The French and Italian governments have gained support at the expense of the Communist parties in their countries by taking a firm rhetorical line against the Polish crackdown--a rhetorical line that costs them little. Following up with firm action, however, particularly if such action appears forced on them by Washington, could be costly and divert criticism from the Communists to the governments.